REPORT

DATE: July 12, 2007

TO: Administration Committee
Regional Council

FROM: Wayne Moore, CFO, 213-236-1804; moore@scag.ca.gov

SUBJECT: GASB 45 – OTHER POSTEMPLOYMENT BENEFITS; SUPPLEMENTAL DEFINED BENEFIT RETIREMENT PLAN

EXECUTIVE DIRECTOR'S APPROVAL:

RECOMMENDED ACTION:

Approve the joint recommendation of the Audit and Personnel Committees that:

(a) For financial planning purposes, SCAG's contribution for retiree medical insurance coverage under the Public Employees' Medical and Hospital Care Act (PEMHCA) be increased by 2% triennially, commencing on July 1, 2009;
(b) SCAG establish an irrevocable trust to accumulate related funding; and
(c) The supplemental defined benefit pension plan be funded with a purchased annuity.

BACKGROUND:

At the joint Audit-Personnel Committee meeting of April 12, 2007, it was resolved that the above recommendations should be forwarded to the Administration Committee regarding the issues of GASB 45 (i.e., the retiree medical insurance benefit provided through CalPERS under PEMHCA), and SCAG's supplemental defined benefit pension plan. These recommendations originated from the GASB 45 Working Group. A copy of that group's report is attached. Retirees have been kept fully apprised of developments in this matter.

FISCAL IMPACT:

The FY07 budget includes funding for SCAG's contributions for both the retiree medical insurance coverage and supplemental defined benefit pension plan.

Reviewed by: ______________________
Division Manager

Reviewed by: ______________________
Chief Financial Officer

SOUTHERN CALIFORNIA ASSOCIATION of GOVERNMENTS

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Administration Committee June 2007
Created by B. Panas 5/16/2007 10:00:00 AM

REPORT

DATE: April 12, 2007

TO: Audit and Personnel Committees

FROM: GASB 45 Working Group

SUBJECT: Other Postemployment Benefits; Supplemental Defined Benefit Retirement Plan

RECOMMENDED ACTION:
Recommend to the Administration Committee that:

(a) SCAG's contribution for retiree medical insurance coverage under the Public Employees' Medical and Hospital Care Act (PEMHCA) be increased by 2% triennially, commencing in July 1, 2009;
(b) SCAG establish an irrevocable trust to accumulate related funding; and
(c) The supplemental defined benefit pension plan be funded with a purchased annuity.

BACKGROUND:
At the February 8, 2007 joint Audit-Personnel Committee meeting, it was resolved that a working group be formed and charged with studying the issues of GASB 45, (i.e., the retiree medical insurance benefit provided through CalPERS under PEMHCA), and SCAG's supplemental defined benefit pension plan, and making appropriate recommendations for future action. The Working Group is made up of Hon. Paul M. Nowatka, Hon. Tom Sykes, and Hon. Paula Lantz. The Group met on March 21, 2007, and reached consensus on both issues.

GOVERNMENTAL ACCOUNTING STANDARDS BOARD STATEMENT No. 45, *Accounting and Financial Reporting by Employers for Postemployment Benefits other than Pensions:*
This new accounting standard will be effective for SCAG in FY09. Its premise is to accord the same accounting treatment for all postemployment benefits, whether they be pensions or medical insurance coverage.

It will require us to record in our financial statements, as an annual cost, the actuarially determined annual required contribution (ARC) for the retiree medical benefit (currently $550 per month per eligible retiree). This is the amount needed to be set aside each year if the value of the promise (the present value of projected benefits) is to be fully funded. It covers the benefits currently being paid to retirees and provides funding for future benefits to retired and currently active employees. GASB 45 requires a new actuarial study at least every three years which will require reevaluation of all aspects of the program, including the level of benefits and associated funding. Funding the ARC is not mandated but any unfunded amounts will be reported as balance sheet liabilities which will reduce fund equity accordingly. Additionally, the value of benefits earned through the financial statement date, and associated funding, must be disclosed.

Actuarial computations cannot be finalized until a formal policy on retiree medical premium benefit adjustments and related funding is in place. The FY09 budget cycle commences in September 2007 and will require resolution of these issues by then. The Group considered four options concerning future benefit level adjustments. Table 1 below shows the present value of projected benefits (line 1) and the ARC (line 2) for each option. The current pay-as-you-go cost is $357,000 (line 3). Line 4 shows the net increase in cost beyond the current pay-as-you-go amount of each option. The funding for this type of cost in the FY07 budget totals $41,816,167 currently (line 5). The last line expresses the increase in costs as a percentage of the funding.

Table 1: RETIREE MEDICAL BENEFIT GROWTH OPTIONS

	0% ANNUAL GROWTH	2% TRIENNIAL GROWTH	2% ANNUAL GROWTH	3% ANNUAL GROWTH	
Present Value of Projected Benefits	$ 5,817,000	$ 6,214,000	$ 7,148,000	$ 7,935,000	1
ARC	534,000	579,000	683,000	776,000	2
Pay-as-you-go cost	357,000	357,000	357,000	357,000	3
ARC > pay-as-you-go cost	$ 177,000	$ 222,000	$ 326,000	$ 419,000	4
Qualified Annual Funding	$ 41,816,167	$ 41,816,168	$ 41,816,169	$ 41,816,170	5
ARC>pay-as-you-go cost/funding	0.42%	0.53%	0.78%	1.00%	6

These options were costed assuming a twenty-year amortization of unfunded amounts, i.e., the value of future benefits already earned. The Group considered this preferable to a thirty-year amortization and decided that the 2% triennial growth scenario (commencing July 1, 2009) represented the best choice for SCAG. The Group determined that SCAG should fund the related ARC amount of $579,000 annually in an irrevocable trust. All amounts were expressed in today's dollars by using a discount factor 0f 7.75%, the rate applicable to irrevocable trusts. The Group was very mindful of the fact that all of the actuarial estimates were a function of their assumptions and thus subject to variability.

SUPPLEMENTAL DEFINED BENEFIT PENSION PLAN:

SCAG adopted a supplemental defined benefit pension plan effective 1/1/02 to compensate eleven employees, who took early retirement packages, for value lost when CalPERS disallowed part of their anticipated benefits. The actuarially determined present value of this obligation amounts to $732,654. The Group determined that the current pay-as-you-go policy for funding was not acceptable. They considered two other options, shown in Table 2:

Table 2: SUPPLEMENTAL RETIREMENT FUNDING OPTIONS

	NET PRESENT VALUE OF COST	ADVANTAGES	DISADVANTAGES
Self-Directed Investment	$751,769 for 100% prefunding; or $830,970 for 5 annual installments	Theoretically cheapest option	Uncertainty of investment performance
Purchased Annuity	$935,731 for lump sum purchase; or $1,024,070 for 5 annual installments	Known cost	Counterparty risk

The Group rejected the self-directed investment option because of the risk inherent in the financial markets. They determined that SCAG's risk capacity would be better spent on decisions relating to its core mission. Thus, the Group settled on the purchase of an annuity with safeguards to mitigate the associated counterparty risk.

FISCAL IMPACT:
The FY07 budget includes funding for SCAG's contributions for both the retiree medical insurance coverage and supplemental defined benefit pension plan.

Reviewed by: Paul M. Nowatka
Hon. Paul Nowatka

Reviewed by: Tom Sykes
Hon. Tom Sykes

Reviewed by: Paula Lantz
Hon. Paula Lantz